

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:03
PLR-118579-13
Date:
October 22, 2013

Legend

Corporation =

LLC =

State A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Shareholder A =

Shareholder B =

Employee A =

Employee B =

Employee C =

Employee D =

Agreement 1 =

Agreement 2 =

Agreement 3 =

a =

b =

c =

d =

e =

f =

Dear :

This letter responds to your March 26, 2013 request for rulings on certain federal income tax consequences of the proposed transaction described below. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a “penalties of perjury” statement executed by an appropriate party. This office has not verified any of the material

submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

FACTS

Corporation is a calendar-year, accrual-basis taxpayer that was incorporated under the laws of State A on Date 1. Corporation elected to be an S corporation (within the meaning of section 1361(a)(1) of the Internal Revenue Code) for its first year of existence, and such election has been in effect continuously; Corporation never has been taxed as a C corporation.

Corporation has a shares of common voting stock (and no other stock) outstanding. Its shares are held in equal part by Shareholder A and Shareholder B (the "Shareholders"), both of which are U.S. citizens.

The Shareholders wish to retire and transfer the ownership and operation of Corporation to Employee A, Employee B, Employee C, and Employee D (the "Key Employees"). Thus, Corporation proposes to undertake the following transactions (together, the "Proposed Transaction") in accordance with Agreement 1, Agreement 2, and Agreement 3 (the "Agreements"):

- (i) First, Corporation will redeem all of its outstanding shares from the Shareholders (the "Redemption") in exchange for promissory notes with a face amount of \$b (the "Notes"). The redemption price was determined by a third-party appraisal.
- (ii) Second, immediately after the Redemption, Corporation will reissue c of its shares (which will be subject to transfer restrictions and service-related risks of forfeiture) to the Key Employees (the "Reissuance"). Corporation will retain its remaining d shares for issuance to future employees.

After the Proposed Transaction, the only outstanding shares of Corporation stock will be common stock owned by the Key Employees (with each owning d shares).

The Notes will require semiannual payments of principal and interest over a period of e years starting in Year 1. The Notes will provide for a fixed interest rate of f% that will exceed the mid-term applicable Federal rate (compounded semiannually) in effect as of the day on which the Notes are issued. The Notes' interest rate and payment dates will not be contingent on Corporation's profits, Corporation's discretion, the payment of dividends with respect to Corporation's common stock, or similar factors. The Notes also will not be convertible (directly or indirectly) into stock or any other equity interest of Corporation.

The Shareholders will have continuing relationships with Corporation after the Proposed Transaction. Shareholder A will remain employed by Corporation until Date 2 and will continue to serve as Vice-Chairman of Corporation's Board of Directors until Date 3. Shareholder B will remain employed by Corporation until Date 4 and will continue to serve as Chairman of Corporation's Board of Directors until Date 3. LLC (another company wholly owned by the Shareholders) also will continue to own the building in which Corporation rents space.

REPRESENTATIONS

Corporation makes the following representations in connection with the Proposed Transaction:

- (a) There are no outstanding options or warrants to purchase Corporation stock, and there are no outstanding debentures or other obligations that are convertible into Corporation stock or that would be considered Corporation stock.
- (b) In no event will the last payment on the Notes be made more than 15 years after the date of issuance of the Notes.
- (c) None of the consideration (including interest) to be paid by Corporation to the Shareholders consists entirely or partly of Corporation's promise to pay an amount that is based or contingent on future earnings of Corporation, an amount that is contingent on working capital being maintained at a certain level, or any other similar contingency.
- (d) The Notes will not be subordinated to the claims of general creditors of Corporation, and there is no plan or intent for the Notes to be subordinated to the claims of any creditor.
- (e) The payments that Corporation will make to or on behalf of LLC for the use of LLC's property after the Redemption are not dependent upon Corporation's future earnings, are not subordinate to the claims of Corporation's general creditors, and reflect arm's-length terms.
- (f) Corporation's stock will not be held in escrow or as security for payment of the Notes. In the event of a default on the Notes, no shares of Corporation stock will revert to or be received by Shareholder A or Shareholder B (or any person or entity related thereto), and neither Shareholder A nor Shareholder B (nor any person or entity related thereto) will be permitted to purchase Corporation stock at a public or private sale.
- (g) No shareholder of Corporation has been or will be obligated to purchase any of the stock to be redeemed in the Redemption.

- (h) The Redemption is related to the Reissuance. Otherwise, the Redemption is an isolated transaction not related to any other past or future transaction.
- (i) There have been no redemptions, issuances, or exchanges by Corporation of its stock in the past five years.
- (j) Except for the Proposed Transaction, Corporation has no plan or intention to issue, redeem, or exchange any shares of its stock.
- (k) Neither Shareholder A nor Shareholder B is related, within the meaning of section 318, to any of the Key Employees.
- (l) None of the stock to be redeemed in the Redemption is “section 306 stock” within the meaning of section 306(c).
- (m) There are no declared but unpaid dividends, or funds set apart for dividends, on any of the stock to be redeemed in the Redemption.
- (n) At the time of the Redemption, the fair market value of the consideration to be received by each of Shareholder A and Shareholder B will be approximately equal to the fair market value of the Corporation stock to be exchanged therefor.
- (o) The fair market value of the Corporation shares to be issued to the Key Employees in the Reissuance shall be determined annually pursuant to § 3.01 of Agreement 3, and the fair market value as so determined shall be used for purposes of all future transactions involving such shares. Thus, the amount to be paid for such shares in any future transactions will not be significantly in excess of or below the fair market value of the stock.
- (p) The price to be paid for Corporation’s stock to be redeemed in the Redemption will not result in a loss with respect to such shares.
- (q) Corporation has had only one class of common stock outstanding at all times, and all shares of this one class of Corporation common stock have identical rights to Corporation’s distribution and liquidation proceeds. There are no differences in rights that occur under Corporation’s articles of incorporation or bylaws, or by operation of state law, or under binding agreements relating to distribution and liquidation proceeds, or under any other document, agreement, or understanding concerning the shares held by Shareholder A or Shareholder B.
- (r) Corporation will issue only shares of Corporation’s one outstanding class of common stock to the Key Employees in the Reissuance, and all shares of such stock will have identical rights to Corporation’s distribution and liquidation

proceeds. Corporation will continue to have only common stock outstanding after such issuance, and all shares of Corporation's common stock will have identical rights to Corporation's distribution and liquidation proceeds. There will be no difference in rights that occur under Corporation's articles of incorporation or bylaws, or by operation of state law, or under binding agreements relating to distribution and liquidation proceeds, or under any other document, agreement, or understanding concerning the shares held by the Key Employees.

- (s) The Redemption is neither (i) a disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan, nor (ii) a disposition of personal property of a kind required to be included in the inventory of any redeemed shareholder at the close of the taxable year. The Notes will not be issued in any form designed to render them readily tradable on an established securities market.
- (t) The Notes and Agreement 2 will not contravene the rights conferred by Corporation's outstanding stock after the Proposed Transaction with regard to distribution or liquidation proceeds.
- (u) No shareholder of Corporation has been or will be required to purchase any of the stock to be redeemed in the Redemption.
- (v) The principal purpose of issuing the Notes and the Agreements is not to circumvent the rights to distributions or liquidation proceeds conferred by the outstanding shares of Corporation stock or to circumvent the limitations on eligible shareholders contained in Treas. Reg. § 1.1361-1(b)(1).
- (w) As a condition of receiving Corporation stock in the Reissuance, each Key Employee will elect to include the value of the Corporation stock received in income in the year the stock is received pursuant to section 83(b).
- (x) Corporation stock is not a marketable security as defined by section 453(f)(2).
- (y) The Notes are not and will not be self-cancelling promissory notes.
- (z) The Notes are not payable on demand within the meaning of section 453(f)(4) and Treas. Reg. § 15a.453-1(e).

RULINGS

Based on the information and representations submitted by Corporation, we rule as follows:

- (1) The Notes will constitute “straight debt” as defined in section 1361(c)(5)(B).
- (2) The Redemption will be a “complete termination” of Shareholder A’s and Shareholder B’s respective interests in Corporation within the meaning of section 302(b)(3). The amount distributed in the Redemption will be treated as a distribution in full payment in exchange for the stock surrendered as provided in section 302(a).
- (3) As provided in section 1001, the Shareholders will realize and recognize gain on the Redemption. For each share of stock surrendered, gain will be measured by the difference between the redemption price and the adjusted basis of such share as determined under section 1011. Provided that Corporation stock is a capital asset in the hands of the Shareholders, the gain will constitute capital gain subject to the conditions and limitations of Subchapter P of Chapter 1 of the Code.
- (4) The Shareholders will qualify to report gain on the Redemption using the installment method under section 453. In the event the Notes are cancelled or otherwise become unenforceable, the Notes will be treated as if they were disposed of for fair market value, which will be treated as not less than their face amount under section 453B(f)(1) and (2).
- (5) Interest received by each Shareholder on the Notes will be taxable as ordinary income under section 61(a)(4) in the year the Shareholder receives the interest.
- (6) Corporation will not recognize gain or loss on the distribution of the Notes in redemption of its stock under section 311(a).
- (7) The interest paid by Corporation on the Notes will be deductible under section 163.

CAVEATS

Except as expressly provided herein and specifically set forth in the rulings above, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter, or concerning the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction.

PROCEDURAL MATTERS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Russell G. Jones
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel (Corporate)